

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MONTANA

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IN THE MATTER of the application of)
the Great Falls Gas Company for authority) DOCKET NO. 4693
to increase its rates and charges for natural)
gas service in the territory served by it.)

IN THE MATTER of the application of)
The Montana Power Company for an order) DOCKET NO. 4697
changing the rates and conditions of service)
for natural gas to the Great Falls Gas Company.)

* * * * *

ORDER NO. 2759

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BE IT REMEMBERED, that these matters were regularly heard before the Public Service Commission of the State of Montana in accordance with the notices of hearing issued in these dockets with the first half of the public hearings commencing at the hour of 10:00 o'clock A.M. on the 23rd and 24th days of July, 1958, in the City Council Chambers in the Civic Center in the City of Great Falls, Montana; and with the second half of said hearings commencing at the hour of 10:00 o'clock A.M., on the 12th day of November, 1958, in the City Council Chambers in the Civic Center, in the City of Great Falls, Montana.

APPEARANCES:

Edmond G. Toomey of the law firm of Toomey and Hughes, 11 Edwards Street, Helena, Montana;

I. W. Church and Carter Williams of the law firm of Church, Harris, Williams and Johnson, Ford Building, Great Falls, Montana, appearing for the applicant Great Falls Gas Company in Docket No. 4693 and for the Great Falls Gas Company, protestant in Docket No. 4697.

Sam B. Chase, William H. Coldiron, John C. Hauck and Robert D. Corette, Attorney for The Montana Power Company, 40 East Broadway Street, Butte, Montana, appearing for the applicant The Montana Power Company in Docket No. 4697, and for The Montana Power Company in Docket No. 4693, as its interests may appear.

PROTESTANTS:

Leo C. Graybill, Jr. of the law firm of Graybill, Bradford and Graybill, 710 First National Bank Building, Great Falls, Montana, appearing for the Cascade County Trades & Labor Assembly and Local No. 16 of Mine, Mill and Smeltermen's Union.

Howard C. Burton, Attorney at Law, Strain Building, Great Falls, Montana and Leo C. Graybill, Jr., of the law firm of Graybill, Bradford and Graybill, 710 First National Bank Building, Great Falls, Montana, appearing for the Businessmen's Utility League of Great Falls, Montana, as Intervenors and Protestants.

FOR THE COMMISSION:

Clinton J. Hansen, Counsel

BY THE COMMISSION:

On May 19, 1958, the Great Falls Gas Company filed with this Commission an application for authority to increase its rates and charges for natural gas service. This application was set for public hearing on July 23, 1958, in Great Falls, Montana, and notice of said hearing was duly issued. Docket No. 4693 was assigned to this case.

On July 8, 1958, The Montana Power Company, which supplies natural gas to the Applicant, filed with this Commission an application alleging that the contract under which it provides gas to the Great Falls Company was unjust and unreasonable. It requested the Commission to cancel the existing contract and establish a new price and conditions of service for the gas supplied by Montana Power to the Great Falls Company. This application was set for hearing on July 24, 1958, and notice was duly issued. This case was assigned Docket No. 4697.

At the outset of both hearings, the Commission adopted the split-hearing procedure. The Great Falls Company presented its case in chief on July 23 and 24, and Montana Power followed with its direct evidence in the other docket on July 24 and 25. Both dockets were then continued.

At the conclusion of these hearings, the Commission admonished representatives of both companies to renew efforts to settle their contract differences by private negotiation. It also requested briefs on the question of the Commission's jurisdiction in regard to such a contract, and these were duly filed. The Great Falls Company had filed formal objections to the exercise of jurisdiction by the Commission in Docket 4697.

The second half of the hearings in both dockets were set for November 10, 1958, in Great Falls and notices were duly issued. At the request of both companies, the hearings were postponed until November 12, at which time both dockets were called. Counsel for The Montana Power Company thereupon presented the Commission with a new contract governing the sale of natural gas to the Great Falls Company. This contract had been agreed upon between the two

companies after prolonged negotiations prior to the hearing. It provided for a higher wholesale price of gas and it stipulated that the agreement would not take effect until it had been approved by the Commission. Montana Power then moved that its application in Docket No. 4697 be dismissed. Objections were raised by counsel for the Protestants herein, and the motion was taken under advisement.

Great Falls Gas Company then was allowed to amend its application by filing a higher schedule of rates designed to incorporate nearly all of the increased wholesale price of gas specified by the new contract and thereby provide Great Falls Gas with approximately the same amount of net revenues as its original schedule of proposed rates. After this amendment, the second half of the hearing in Docket No. 4693 was conducted, during which Applicant's witnesses were extensively cross-examined and some additional proof was offered. The hearing was concluded on November 14, 1958. The record contains 575 pages of testimony by the 12 witnesses presented by Applicant and one called by the Commission. Protestants offered seven exhibits but no witnesses; Applicant submitted 36 exhibits and provided various other information and data requested by the Commission and Protestants.

Final briefs were submitted on April 7, 1959, and the case was thereupon deemed submitted. No further proceedings were had in The Montana Power case, Docket No. 4697.

THE NEW GAS CONTRACT

Under the increased price established in the proposed new contract, the cost of gas to the Great Falls Company would be increased by more than \$330,000 a year. Thus, it is obvious that this proposed contract must be dealt with before any determination can be made upon the rate application of Great Falls Gas.

The existing gas purchase contract has been in effect since 1927, and Montana Power has been the supplier under the agreement since November 1, 1954, when it purchased the interests of the Montana-Dakota Utilities Company in the contract. It made various attempts to negotiate a new contract rate with Great Falls Gas after that purchase, but no new agreements were effected until the proposed contract was agreed upon just prior to the resumption of the hearings involved here.

The present contract specifies a maximum rate of 26¢ per mcf for gas delivered to Great Falls Gas at its city gate. However, this rate averaged 22.7¢ per mcf during the test period under consideration. In its application to the Commission, Montana Power requested that this rate be increased to 39¢ per mcf.

After the July hearings, preliminary negotiations were resumed by the two companies. An exhaustive study was made by the experts counseling Great Falls Gas, and they determined on the basis of this study that 29.43¢ per mcf would be a fair and reasonable price for the

distributing company to pay Montana Power. Final negotiations were conducted during the week prior to the resumption of the hearings in November. The testimony shows these sessions were intense, with each company vigorously asserting its arguments. A few hours before the hearings were to be resumed, agreement was reached and the new contract was approved. It specifies a price of 30.75¢ per mcf.

There were serious legal questions raised in the July hearing concerning the Commission's power to cancel an existing contract of this type and compel a gas distributing company to pay a specified price to the supplier. There also was a question raised as to whether Montana Power could be compelled to provide gas from its Canadian sources under the terms of the existing contract.

However, these questions need not be resolved. The issues became nugatory when the two companies agreed upon the new contract. The only determination now necessary is whether this new contract should be approved.

It has been the practice of this Commission to examine and approve or disapprove special contracts entered into between utilities and their large users. The purpose of this procedure is, of course, to assure that the rates and terms of the agreement do not provide the contract customer with any unfair or unreasonable advantage over the utility's other users who are charged under established rate schedules.

Protestants object to any approval of the new gas contract on the grounds that the public was not a party to the negotiations and hearings should be held on the contract because of its impact upon the rates of Great Falls Gas. We are certainly cognizant of the fact that an increase in the purchase price of the gas will have to be passed on to the retail customers. However, we could not insist upon a perpetuation of the present contract simply because it gives an advantage to the customers of Great Falls Gas. The customers of Montana Power also must be considered. If that company is required to provide gas to Great Falls Gas at an unreasonable rate, then an unfair burden is imposed upon its other gas customers. Consideration of the new contract requires a balancing of the interests of the two utilities and their customers.

We see no need for public hearings on the new contract. If there were any doubts about nature of the transaction, then an investigation and hearings would be proper. But here the negotiations were clearly conducted at arm's length. Both utilities were armed with experts and voluminous statistical and other specialized data. Great Falls Gas was fully capable of asserting its interests and the evidence shows that it did so in vigorous fashion. While it must pay a higher rate under the new contract, it obtained certain other advantages which will be of ultimate benefit to the customers of Great Falls Gas. The doubtful status of its rights to a continued gas supply was corrected, and it was assured daily and annual gas deliveries which should be adequate to

meet its needs in the foreseeable future. The new price, while increased, is in line with that charged to other contract customers.

After carefully reviewing the proposed contract, we conclude that the gas price and other conditions it establishes are fair and reasonable to both companies, and that the agreement should be approved. Accordingly, the motion to dismiss Montana Power's application in Docket No. 4697 will be granted.

With that issue determined, we turn to the rate request of Great Falls Gas.

COMPANY RATE HISTORY

Great Falls Gas Company (hereafter termed the "Applicant") commenced the distribution of manufactured gas in 1909. In 1928, it began the distribution of natural gas and discontinued the manufacture of gas. It is strictly a distributing company, and it is not engaged in the production or transmission of natural gas. Applicant serves 15,069 customers in the Great Falls metropolitan area and the community of Black Eagle adjacent to Great Falls.

Applicant has not had an increase in rates since natural gas service was commenced in 1928. Its present commercial rates have been in effect since 1931, its industrial rate since 1937, and its general schedule for domestic users since 1939. All of the adjustments made in those years were decreases from previous rates. Applicant presently serves Malstrom Air Force Base under a contract made with the U.S. Air Force in 1950.

In 1955, Applicant applied for approval of a higher schedule of rates designed to increase its gross revenues by 12.07 percent annually. This application was denied by the Commission in its order No. 2529 on October 3, 1955. It held that Applicant's present rates provided it with a return of 6.49 percent and that such return was adequate.

In the rate schedules filed with its present application, Applicant proposed an increase in operating revenues of 15.6 percent. However, after the new contract was reached setting a higher price on gas purchased from Montana Power, Applicant was allowed to amend its application by filing revised rate schedules. Under these revisions, Applicant seeks an increase of 34.97 percent in operating revenues. The testimony was that these higher schedules will not recover quite all of the increased cost of gas. In making this revision, the proposed commercial schedule was eliminated and Applicant seeks authority to charge commercial customers under its general or residential schedule.

Under the revised rates, the amount of operating revenues obtained from the various classes of customers would be increased as follows: general service or residential, 29.16 percent; commercial (charged under the general schedule), 52.99 percent; industrial, 58.87 percent; Air Force, 39.54 percent; and Housing Administration, 44.88 percent.

Applicant alleged in its application that its present rates no longer provide it with a fair rate of return upon the fair value of its utility plant because of increased operating costs such as wages, taxes and the increased price of materials and supplies. It also alleged a need to institute a pension program for its employees.

Much evidence was produced concerning the increases in these costs and their effect upon Applicant's earnings. We are well aware of the impact of higher prices upon utility operations. However, there is only one way by which we can determine whether these increased costs have brought Applicant to the point where its rates do not provide a fair return. The present fair value of its utility plant must be established and its operating results--including the effect of the higher price of gas--must be applied against that valuation to determine the rate of return.

THE RATE BASE

Applicant submitted year-end rate base computations for December 31, 1957, and the identical date for 1958. Its testimony and exhibits were geared to the year 1957, with the actual results for that period adjusted for normal weather, pension costs and other factors. The 1958 figures contained estimates of revenues and expenses, and only \$191,518 of the \$275,227 worth of improvements scheduled for 1958 were completed. Applicant considered 1957 as its test period and submitted the 1958 figures chiefly for comparative purposes. It seems to us that adjustment of actual figures for known and determined factors provides a more satisfactory basis than the estimates for a projected period. Therefore, we will adopt the 1957 annual period as the test year for our determinations.

Applicant presented three measures of valuation: original cost, original cost less depreciation, and trended original cost depreciated. The foundation of these computations was the original cost study developed by Witness Gannon, assistant treasurer of Stone & Webster Service Corporation, the consulting firm retained by Applicant. This study, introduced as Exhibit 13, traces the property accounts of the company from 1910 through 1957, detailing the additions and retirements to the utility plant in each year. All property records of the Applicant were reviewed, and use was made of annual reports to the Commission, the original cost study compiled in 1943 in connection with Applicant's reorganization proceedings, and various other data including a 1948 reclassification of property accounts for the Internal Revenue Bureau.

The book cost of the property on December 31, 1957 was \$2,605,036. However, \$72,061 of this amount was eliminated in the form of adjustments made in the property accounts. Miscellaneous intangibles in the amount of \$18,731 were written off as not properly includable in the original cost determination; \$29,651 in "additions not classified" were written off as non-identifiable. Other items eliminated were: governors and regulators, \$10,338; services, \$9,878; and overheads allocated to manufactured gas plant, \$3,463.

In this connection, the original cost study was reconciled with the adjustments made by the Commission in its Order No. 2529 issued in the 1955 rate case. Those adjustments resulted in a reduction of the original cost determination of \$132,836. As reconciled and coupled with the adjustments made by Witness Gannon, the book cost of the property was adjusted by \$151,570 in comparison with the 1955 adjustment of \$132,836. The analysis of these figures is contained in Exhibit E, prepared by Gannon and introduced by the Protestants.

The final result is the determination of an original cost of \$2,532,975 for Applicant's property as of December 31, 1957. The depreciation reserve, as adjusted for the retirements made in the original cost study, amounts to \$529,294, and contributions in aid of construction totaling \$7,410 were added to reduce the original cost less depreciation figure to \$1,996,271.

Applicant's trended original cost valuation was computed by applying cost indices to the original cost of various items of plant. Indices were taken from the Handy-Whitman Index of Public Utility Construction Costs, long recognized as an authoritative publication on cost trends. The Handy-Whitman indices were applied in three classes of property, structures and improvements, pumping and regulating equipment, and services. Special indices were prepared for the three other classes of plant property trended, mains, meters and meter installations, and house governors and governor installations. These special indices were formulated by an associate engineer for Whitman, Requardt and Associates, the firm which publishes the Handy-Whitman Index. We are satisfied from the evidence that the indices provide a high degree of accuracy for the trending, or translation, of these costs into "present-day" dollars. Protestants argued against the first-in, first-out theory in applying retirements to the plant account. However, this is the accepted method and it has been recognized by this Commission in previous cases.

By applying the appropriate indices to the original cost of \$2,358,847, a trended original cost of \$4,413,552 was developed for these six categories of plant. No indices were prepared for general equipment such as office furniture, tools and transportation equipment, and this group of accounts was included in the trended cost computation at its original cost of \$167,719. The original cost of the land owned by Applicant is \$6,409 and this was appraised at \$88,480 by a Great Falls real estate dealer and that increased figure was used in the trended cost computation. The total trended original cost valuation was \$4,669,751.

Witness North, a well-qualified engineering expert, developed the per-cent conditions of the various items of plant for which costs had been trended. These conditions ranged from 75 per cent to 85 per cent. His findings were based upon an extensive inspection of the properties, including sample excavations of mains and services, and soil testing. In view of the fact that 60 per cent of the plant had been installed in the years since the end of World War II, his estimates of present conditions appear sound and reasonable. The percent conditions for the general equipment such as office furniture were developed by the Stone & Webster staff and these

conditions ranged from 60 per cent to 90 per cent. Applied to the trended original cost the per-cent conditions of various plant items result in a total depreciation determination of \$925,823. By applying this depreciation to the total trended original cost of \$4,669,751, we compute the

Applicant's trended original cost depreciated at \$3,743,928 as of December 31, 1957.

There was no plant under construction at the end of 1957 and Applicant has no land held for future use. No allowance for cash working capital was included in the rate base computations, so no inquiry is required in that respect.

Applicant did include the item of \$58,322 for materials and supplies. It was conceded that these materials are regularly used for construction. It also was estimated that between 10 and 15 per cent of the supplies kept on inventory are used to connect appliances sold by Applicant. Thus it appears, that the allowance for materials and supplies is in excess of that required by Applicant for the everyday inventory needs of its utility functions. While there is no specific estimates in the record, we feel that a reduction of this item by 50 per cent would be reasonable, and this amount will be included at \$29,161 instead of \$58,322.

One other adjustment must be made. In computing its trended original cost, the value of land was included in the amount of \$88,480. Its original cost was \$6,409. We recognize that land values have increased and we certainly do not quarrel with the appraisal. However, it must be recognized that the value is relative when it is considered that Applicant is utilizing this property for its utility functions and is not holding it for speculative purposes. Furthermore, in previous cases before this Commission involving major utilities, land and land rights were carried at their original cost in the computation of the reproduction cost new less depreciation of utility properties. We feel that consistency demands the same type of treatment in this case. Accordingly, the difference of \$82,071 between the original cost of \$6,409 and the appraisal of \$88,480 will be deducted from the trended original cost depreciated valuation. With this deduction, and with the addition of \$29,161 for materials and supplies on all three valuations, we arrive at the following computations of rate base as of December 31, 1957:

Original Cost	\$ 2,562,136
Original Cost Less Depreciation	2,025,432
Trended Original Cost Depreciated	3,691,018

The assessed valuation of the Applicant's properties amounted to \$1,558,803 for the year 1957.

We have expressed our views on all four of these standards of valuation in recent cases, and we see no need to discuss them in detail here. While the computation of trended original cost differs in method from that used in reproduction cost, the general theory is the same and it deserves the same measure of reliability.

After carefully reviewing all of the testimony concerning valuation, and after analyzing the various exhibits and records dealing with the computations of plant value, we conclude that the present fair value of Applicant's property used and useful for the convenience of the public was \$2,992,000 as of December 31, 1957.

OPERATING RESULTS

Applicant received operating revenues of \$1,694,217 for the year 1957. Operating expenses, depreciation and taxes amounted to \$1,578,902, leaving Applicant with net operating revenues of \$115,315 for that annual period. Applied to the rate base of \$2,992,000, this figure results in a rate of return of 3.85 per cent. Thus, it is clear that Applicant's present schedule of rates is insufficient to provide a fair and adequate return upon the present fair value of its utility plant.

In order to determine the amount of net operating revenues which could be derived under the proposed rates, Applicant applied them to the 1957 year after making adjustments for increased expenses, weather and taxes. Protestants dispute these adjustments on several grounds, contending that they cause a distortion of Applicant's operating picture. We agree that actual results provide the best means of determining the reasonableness of rates. However, we have the obligation to fix rates for the future, and this problem is further compounded in this case by certain costs such as the proposed pension plan for which no actual figures are available. We conclude that accuracy will be served best by adjusting actual results for known and defined costs, rather than attempting to forecast or predict the results for some future period. This is especially true of a gas utility because of the vulnerability of its gas sales to fluctuations in weather conditions.

Therefore, the 1957 year, as adjusted, will be used as the test period for this proceeding.

Applicant's first adjustment amounted to \$19,400 for salary and wage increases granted to employees in 1957 and 1958. Applicant already is obligated to meet these increased wage costs and they will have to be paid in all future years. The evidence does not show any reduction in the labor force which could be offset against these increases, and the adjustment will be allowed.

An item of \$34,900 was added to expenses for the estimated annual cost of Applicant's proposed employee retirement program. Protestants contend this expense should not be allowed until the program actually is placed into operation. They also argue that the cost of this program is inflated by payments which will be made to four employees who are now beyond retirement

age, and by other payments required in the first year of the program to build up the necessary funds.

It is beyond dispute that, in these times, an adequate pension program is essential to the retention of experienced employees and the enlistment of capable workers. It is well established that a utility's pension costs are allowable expenses for rate-making purposes. Applicant has no program at the present time and we feel that the adoption of a pension plan is necessary to its continued operation. We also feel that it will be of ultimate benefit to Applicant's customers.

The costs of the program are definite and the plan has been well formulated. We cannot agree that this expense should be disallowed because the plan is not yet in operation. To deny it at this time would only mean that a future rate adjustment would have to be made when the program takes effect. We also think Applicant has taken a commendable attitude in providing for those workers who have already reached the age for retirement. These employees have given many valuable years of service and fairness requires that they be included in the retirement benefits. While payments to them and the payments to build up the necessary funds for benefits to other workers with long service will impose considerable expense, we feel it is necessary and reasonable. The adjustment, therefore, will be allowed.

Applicant also added \$3,200 for the increased amount of tax it will be required to pay under the 1957 increase in the tax rate for natural gas distributors. It also amortized the estimated cost of this rate case over a 5-year period, which resulted in an annual cost of \$4,700. Both adjustments will be allowed.

Applicant also adjusted its operating revenues downward by \$28,743 to reflect gas sales for a normal weather period. This was done by comparing the total number of "degree days" in 1957 with the annual average for the Great Falls area for the past 30 years. It was found that 1957 exceeded the average by 2.6 per cent and the appropriate revision was made in the revenues for this colder-than-average weather. While we doubt that such a thing as "normal" weather exists in Montana, we recognize that the formulation of gas rates should be based upon average weather because of the sharp effect periods of abnormal weather have upon gas revenues. The use of degree days is a well recognized method and we will accept the adjustment. The cost of gas purchased by Applicant also was reduced proportionately for this weather adjustment.

The final adjustment is the addition of \$330,989 for the increased cost of wholesale gas for the pro forma annual period under the new contract with Montana Power.

After allowing for the effect of income taxes, these adjusted expenses result in a total of \$2,052,545 for operating expenses, depreciation and taxes for the pro forma period. Under its proposed rates, Applicant would receive operating revenues of \$2,251,119 for the period after normalization for weather. This would provide net operating revenues of \$198,574. This figure,

applied to the rate base of \$2,992,000, results in a rate of return of 6.64 per cent for the pro forma period under the proposed rates.

However, we feel other adjustments must be made. Applicant is engaged in the merchandising of appliances and we have held that such business activity should be segregated from utility operations for rate-making purposes. See Application of Montana-Dakota Utilities Co., Docket No. 4537, Order No. 2750. Applicant correctly applied its profit from merchandise sales of \$8,323 against sales promotion expenses for 1957. However, the evidence shows that this figure represents only the amount by which the sales exceed the cost of merchandise and the direct expenses involved in appliance installations. A report by the Commission auditor shows that the following 1957 expenses are directly attributable to merchandise sales: sales salaries, \$15,477; advertising of merchandise, \$11,470; sales supplies, \$6,703; and sales commissions, \$6,038. These expenses total \$39,688, and while the merchandising profit of \$8,323 was applied against them, this procedure still left \$31,365 in expenses which are due to Applicant's merchandising business rather than its utility operations. This, of course, places an unfair burden upon the rate payers and we will accordingly disallow \$31,365 in expenses.

The fact that Applicant did not make a complete segregation of its merchandising operations leaves us with no alternative but to make the best adjustment possible from available records. We have no means by which to adjust the rate base for property used solely for merchandising. No doubt there is some transportation equipment, office furniture and other items of plant which are used exclusively for merchandising purposes. However, the total effect of such segregation probably would be nominal and we will not insist upon it here, although it should be noted by Applicant in the event of future rate proceedings.

In the 1955 case, the Commission denied \$8,000 in payments to the chairman of Applicant's board of directors and the executive vice president on the ground that the evidence did not disclose the performance of necessary services sufficient to justify such payments. In 1957, payments to these same two non-resident officers were \$5,000 and \$3,172 or a total of \$8,172. It does not appear from the evidence in this proceeding that the functions of these officers have been enlarged since 1955. Therefore, we feel that consistency demands the exclusion of these payments in this case.

By disallowing this item of \$8,172 and the \$31,365 in merchandising expenses, Applicant's operating expenses are reduced by \$39,537. After allowing for increased income taxes, this would add \$18,510 to Applicant's net operating revenues and increase that figure under the proposed rates from \$198,574 to \$217,084. The rate of return is thereby increased to 7.25 per cent.

To summarize, our examination of the operating results, both actual for 1957 and as adjusted pro forma under the proposed rates, provides these results.

	<u>Revenues</u>	<u>Rate Base</u>	<u>Return</u>
1957, actual results	\$115,315	\$2,992,000	3.85%
As adjusted by Applicant*	198,574	2,992,000	6.64%
As adjusted by Commission*	217,084	2,992,000	7.25%

* includes proposed rates

RATE OF RETURN

Applicant's testimony concerning the rate of return was presented by a vice president of Stone & Webster and by an officer of a Great Falls bank. The latter testified that under the present rate structure, Applicant would be unable to obtain a \$500,000 long-term bank loan because its net profits would be inadequate to make the principal payments without the use of depreciation funds. He concluded that increased rates were necessary to allow Applicant to maintain its depreciation reserve, retire its debts in orderly fashion and pay a reasonable dividend to its stockholders.

Present conditions in the money market and other factors involved in the determination of a rate of return were discussed by the Stone & Webster witness. In his exhibits, he developed that Applicant's earnings-per-share declined from \$1.26 in 1951 to 98¢ in 1957. He compared this decrease of 22 per cent for the Applicant with an average increase of 40 per cent in earnings-per-share experienced by 31 other gas distributing companies during this same period.

Applicant proposed to issue \$500,000 of first mortgage bonds to pay off its present \$300,000 of short-term bank loans and the additional \$200,000 in loans it expensed to make for the financing of system expansion. This was proformed by the witness to show that under its present rates, Applicant's bond interest coverage would be only 1.8 times compared with the 4.2 times coverage maintained by other gas distributing companies. Applicant's debt ratio is 39.7 per cent.

The witness said such bonds might be sold at a rate of about 5 per cent. However, he pointed out that Applicant now pays 1/2 of 1 per cent over the present prime rate for bank loan money, and that its sharp decline in earnings makes any prediction difficult in regard to the rate which may be demanded by institutional investors.

The substance of the testimony was that competition is keen in the current money market, and that Applicant is handicapped in attracting capital because of its present poor earnings, the deterioration of its basic credit, and the fact that it is a small company with no established rating or identity in the money market. The conclusion was that the proposed rates were necessary to

provide Applicant with sufficient earnings to maintain adequate bond interest coverage, restore its basic credit, uptrend its earnings-per-share to a reasonable level, and enable it to compete for the necessary capital.

Protestants contend that Applicant's situation cannot be fairly compared with the other distributing companies cited because of differences in size and operation. We agree to a large extent. In fact, the lack of comparisons poses a peculiar problem here. There are no similarly situated utilities in Montana; Applicant has no established rating; its last bonds were sold privately, and there are other aspects about its operation which make it unique.

In the 1955 case, we determined that the existing rates provided Applicant with a rate of return of 6.49 per cent. This was declared adequate and the increased rates were denied. It was not determined whether a lesser return would have been sufficient.

It is obvious that the return of 3.85 per cent allowed by the present rates is inadequate. And it is equally clear that the return of 7.25 per cent which would be derived from the proposed rates is excessive.

There are, of course, many intangible factors which must be considered in determining a fair rate of return. In essence, it involves the exercise of experienced judgment based upon relevant statistical information and the various intangible factors involved in the particular situation of the utility under consideration.

We agree that a gas distributing utility should earn a somewhat higher rate of return than an electric utility. Electric utilities have more stability in that their sales are not subject to the fluctuations of weather, and they are not faced with the problems of supply and cost of gas which plague gas utilities. The evidence shows that gas utilities now pay about $\frac{1}{4}$ of 1 per cent more for bond money than do electric utilities with comparable ratings.

In this inflationary period, the problem of attrition also must be given some consideration. This is especially true here since the Applicant has shown a marked deterioration in earnings during the recent years of mounting costs. However, by adjusting its 1957 operations for all anticipated and determined increases in expense, Applicant has compensated for any problems of attrition in the immediate future.

It seems to us that Applicant's potential growth was not given enough weight, and it does not reflect in the adjustments made by Applicant. During 1958, Applicant had a net gain of 772 customers. The Great Falls area is expanding rapidly and this rate of growth should continue for the Applicant in the foreseeable future. This will naturally enhance Applicant's financial position. With this growth, Applicant should be able to overcome the effects of attrition and even better its earnings position.

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After considering all of these various matters and after reviewing the pertinent evidence, we conclude that Applicant should be allowed to earn a rate of return of 6 per cent upon the present fair value of its utility plant. Such a return is fair and reasonable, and it will enable Applicant to pay its operating expenses, attract the necessary capital, provide a sufficient reserve for depreciation, maintain financial stability, and otherwise perform its functions as a Public utility.

ADJUSTMENT OF RATES

Under its proposed rates, Applicant would earn a rate of return of 7.25 per cent. Therefore, some adjustment must be made in the rates submitted for approval.

On a rate base of \$2,992,000 net revenues of \$179,520 would be necessary to provide the authorized rate of return of 6 per cent. We have found that on the adjusted basis, Applicant's net revenues would be \$217,084 under its proposed rates, or \$37,564 more than we find to be necessary. To reduce the net operating revenues by that amount, it will be necessary to reduce the gross operating revenues by \$80,236. This results in the desired net operating revenues of \$179,520 after adjustment for income taxes, as is shown on the following table:

	Pro Forma After Rate Increase and Adjustments (1)	Adjustments for Expense Items Disallowed	Adjustments for Deduction of Gross Revenues	Final Results After Adjustments
Operating Revenues	\$2,251,119		(80,236)	2,170, 883
Operating Revenue deductions:				
Gas purchased	1,324,351			1,324,351
Other expenses	388,856	(39,537)		349,319
Depreciation	69,721	69,721		
Taxes:				
Income-Federal & State	175,894	21,027 (2)	(42,672) (2)	154,249
-Deferred Federal	5,684			5,684
Other taxes	88,039			88,039
Total operating revenue deductions: \$2, 052;545		21,027	(42,672)	\$1,991,363
Operating Income	\$198,574	18,510	(37,564)	179,520

(1) Includes increased revenue under proposed rates and other adjustments per column 5, exhibit 34

(2) @ 53.183%

There is some conflict in the exhibits regarding the exact amount of increased revenues sought by the Applicant. Witness Cromer, in Exhibit 32, developed an increase figure of \$583,320.

However, Exhibit 34 shows increases of \$261,901 and \$323,744 for a total increase under the proposed rates of \$585,645. This is a difference of \$2,325 from the Cromer figure.

Exhibit 34 and Exhibit 32 both are based on the same actual 1957 figure of \$1,694,217 for operating revenues under the present rates. Cromer reduced this by \$26,418 to reflect normal weather, leaving adjusted revenues of \$1,667,799.

He then added \$583,320 for the amount of increased revenues to be obtained under the proposed rates for a total revenue figure of \$2,251,119.

In Exhibit 34, a second adjustment of \$8,743 is made to reflect the correction made by Cromer in his degree-day calculations of normal weather. However, this amount added to the first adjustment for normal weather of \$20,000 on Exhibit 9 (from which Exhibit 34 was developed) makes a total of \$28,743 for weather adjustment whereas Cromer's Exhibit 32 shows a total weather adjustment of only \$26,418. The difference is \$2,324, which explains the variance in the two increase figures. They can be reconciled as follows:

	Exhibit 32	Exhibits 34 & 9
Actual 1957 revenues	\$1,694,217	\$1,694,217
Less: weather adjustment	-26,418	-28,743
	\$1,667,799	\$1,665,474
Plus increase, new rates	583,320	585,645
Adjusted Operating Revenue:	\$2,251,119	\$2,251,119

Witness Cromer's study of the normalization of weather and its application to the rates was done in great detail and we accept his figure on the adjustment. The adjustment of \$8,743 on Exhibit 34 was in error, as was the amount of increased revenue to be gained from the proposed rates. However, the errors cancel out and result in the same adjusted revenue figure as determined by Exhibit 32.

We conclude, therefore, that the proposed rates would provide increased revenues in the amount of \$583,320 for the test period as adjusted for normal weather. The reduction of \$80,236 in gross revenues must apply against that figure. This leaves \$503,084 to be obtained by increased rates. While the elimination of \$84 will shave the rate of return to 5.99 per cent, we will round the authorized figure to \$503,000 for the sake of simplification.

Applicant will be authorized to file a revised schedule of tariffs which will provide it with not more than \$503,000 in increased revenues on the basis of the 1957 test period as adjusted for normal weather. The exact revisions of its proposed rates will be left to Applicant with the exception that the minimum bill must not exceed \$1.50 per meter per month for those customers under the general service schedule. We feel that the submitted minimum charge of \$1.60 was excessive. We also trust that various classes of customers will share equally in the reductions we have ordered in the proposed rates, and that a revised Exhibit 32 or some other adequate breakdown of the new rates and their application will be submitted by Applicant with its revised schedules.

Applicant also had requested approval of a purchased gas cost adjustment clause in its rate schedules. This would allow automatic upward or downward revisions of rates in proportion to increases or decreases in the future cost of gas purchased by Applicant. We realize that such clauses have been approved in other states, but after careful consideration we feel that the clause should not be allowed. While we would have the power to approve or disapprove any future revision of the gas supply contract, a change in the wholesale price does not always require a similar adjustment of consumer rates. It is entirely possible that Applicant, in some future time, could absorb an increase in the cost of gas; conversely, the situation could arise where it could not afford to decrease its rates after a downward contract change. We feel that an investigation and hearing should be conducted before imposing new rates upon the consumers, and the public should have the opportunity to present its views. For these reasons, the clause will be rejected.

CONCLUSION

The real result of our determinations herein is the authorization of a 30.16 per cent increase in the gas rate structure, as compared to Applicant's request for an increase of 34.97 per cent. Even with this reduction, the new rates will constitute a sharp increase in the cost of natural gas service to Applicant's customers. We are not unmindful of the additional expense this will impose upon individual rate payers. However, the new rates will be in line with those now charged by other gas utilities in other cities of this state.

The major portion of the increased revenues is required to meet the higher cost of gas to Applicant under the new contract. Of the additional \$503,000 which Applicant will receive in revenues under the new rates, \$330,989 will be needed to pay the increased cost of gas. This leaves Applicant with only \$172,011 of the additional revenues. The pension plan alone will cost \$34,900. It is unfortunate that these large items of expense arose at the same time. However, they are necessary expenses and we have no alternative but to authorize the increased rates required to meet them. The same applies to federal and state income taxes which take more than 53 per cent of each dollar of increased revenue provided by the rate payers.

We conclude that Applicant must be authorized to file rates which will provide it with an additional \$503,000 in annual operating revenues on an adjusted basis. Such an increase will provide Applicant with a rate of return of 5.99 per cent, and the additional revenues will be no more than are necessary and essential to enable Applicant to continue the rendition of adequate service to the public.

From the evidence and for the reasons stated, the Commission makes the following:

FINDINGS OF FACT

1. That the Great Falls Gas Company is a public utility engaged in furnishing natural gas service in Great Falls, Montana, and adjacent areas, and is subject to the jurisdiction and authority of this Commission.
2. That The Montana Power Company is a public utility engaged in the production, transmission and distribution of natural gas to the public, and is subject to the jurisdiction and authority of this Commission.

3. That the natural gas distributed by Great Falls Gas Company to its customers is obtained from The Montana Power Company under a special contract.
4. That said companies have renegotiated the terms of said contract and have formulated a new agreement for the supply of natural gas.
5. That the new contract, dated November 12, 1958, between The Montana Power Company and the Great Falls Gas Company, is fair and reasonable and its terms are not discriminatory to the customers of either utility.
6. That said contract should be approved and made effective.
7. That the application of The Montana Power Company in Docket No. 4697 should be dismissed.
8. That the present fair value of the Great Falls Gas Company's utility plant actually used and useful for the convenience of the public was \$2,992,000 as of December 31, 1957.
9. That said Company received net operating earnings of \$115,315 for the year 1957 under its present schedule of rates.
10. That said Company realized a rate of return of only 3.85 per cent on the present fair value of its utility plant for the year 1957; that such a return is not fair, adequate or reasonable.
11. That the Company's rates must be increased in order to provide it with a fair return upon the present fair value of its utility plant.
12. That a rate of return of 6 per cent would be an adequate, fair and reasonable return for said Company to earn.
13. That net operating earnings of \$179,520 are necessary to provide said Company with a rate of return of 6 per cent upon a rate base of \$2,992,000.
14. That under its proposed rates, said Company would receive \$583,320 in additional operating revenues on an adjusted annual basis; that such additional revenues would provide it with net operating revenues of \$217,084.
15. That the proposed rates are in excess of what is necessary to provide said Company with a rate of return of 6 per cent.
16. That rates designed to provide said Company with \$503,084 in additional operating revenues on an adjusted annual basis would result in net operating earnings of

\$179,520 and provide a rate of return of ~ per cent; that the rounding of the revenue figure to \$503,000 reduces the rate of return to 5.99 per cent.

17. That an increase in operating revenues of \$503,000 will provide said Company with an adequate, fair and reasonable rate of return upon the present fair value of its utility plant.

18. That said Company should be authorized to file rates which will provide it with not more than an additional \$503,000 in operating revenues on the adjusted annual basis used herein.

19. That the monthly minimum bill under the general service schedule should not exceed \$1.50.

20. That the "purchased gas cost adjustment" clause contained in the proposed schedules should not be allowed in the revised rates.

CONCLUSIONS OF LAW

The Commission concludes as a matter of law that the gas supply contract between The Montana Power Company and the Great Falls Gas Company should be approved, and that the Great Falls Gas Company should be authorized to file revised rates which will provide it with not more than an additional \$503,000 in gross operating revenues on the adjusted annual basis used herein.

ORDER

NOW THEREFORE, at a session of the Public Service Commission of the State of Montana, held in its offices in the Capitol Building, Helena, Montana, on June 19, 1959, there being present Chairman Paul T. Smith, Commissioner Austin B. Middleton and Commissioner Jack Holmes, there regularly came before the Commission for final action, the matters and things in Docket No. 4693 and Docket No. 4697 and the Commission now being fully advised in the premises;

IT IS THEREFORE ORDERED that the Great Falls Gas Company be authorized to file revised schedules of rates for general, industrial and special government natural gas service which will increase said Company's annual gross operating revenues by not more than \$503,000 on the adjusted annual basis used in this proceeding.

IT IS FURTHER ORDERED that said revised rates shall be subject to the approval of this Commission.

IT IS FURTHER ORDERED that adequate and satisfactory data be submitted with said revised rates to show in detail the formulation of said rates and their application to the various classes of customers.

IT IS FURTHER ORDERED that said revised rates shall be filed on or before July 1, 1959, and shall become effective 10 days after approval by the Commission.

IT IS FURTHER ORDERED that the purchased gas cost adjustment clause shall be eliminated from the rate schedules when revised.

IT IS FURTHER ORDERED that the minimum monthly bill contained in the revised general service schedule shall not exceed \$1.50.

IT IS FURTHER ORDERED that the natural gas supply contract by and between The Montana Power Company and the Great Falls Gas Company, dated November 12, 1958, shall be, and the same hereby is, approved.

IT IS FURTHER ORDERED that said contract shall become effective on and after July 26, 1959, in accordance with paragraph 3 of said contract.

IT IS FURTHER ORDERED that the application of The Montana Power Company in Docket No. 4697 shall be, and the same hereby is, dismissed.

IT IS FURTHER ORDERED that a full, true and correct copy of this Order be sent forthwith by first-class United States mail to the applicants and all appearances herein.

The foregoing Order was unanimously adopted by the

Public Service Commission of the State of Montana.

DONE in open session at Helena, Montana, this 19th day of June, 1959.

PAUL T. SMITH, Chairman

AUSTIN B. MIDDLETON, Commissioner

JACK HOLMES, Commissioner

ATTEST:
Catherine DuBois
Secretary
(Official Seal)